INDEX

	Page
THE FACTS	1
QUESTION PRESENTED	3
STATUTE INVOLVED	3
ARGUMENT	5
I. What Gavit received was income, taxable at normal and surtax rates under Section II of the Income Tax Act of 1913	5
II. The cases cited by the Circuit Court of Appeals are inapplicable	21
III. The effect upon the Income Tax Acts of 1916, 1918, 1921, and 1924	31
IV. Constitutional question involved	33

CASES CITED

Baltzell v. *Casey*, 1 Fed. (2d) 29, affd. C. C. A. 1st Cir., Jan. 14, 1925	34
Brushaber v. *Union Pacific R. Co.*, 240 U. S. 1	36, 37
Cager's Will, In re, 111 N. Y. 343	31
Curtis, In re, 142 N. Y. 219	30
Disston v. *M'Clain*, 147 Fed. 114	25, 26, 28, 29
Eisner v. *Macomber*, 252 U. S. 189	38
Herold v. *Shanley*, 146 Fed. 29	29
Hoffman's Estate, In re, 143 N. Y. 327	30
Lynch v. *Hornby*, 247 U. S. 339	38
Lynch v. *Union Trust Co.*, 164 Fed. 161	21, 22, 28
Maguire v. *Trefry*, 253 U. S. 12	10, 17
Merchants' Loan & Trust Co. v. *Smietanka*, 255 U. S. 509	11, 12, 16, 35
Metcalfe v. *Union Trust Co.*, 181 N. Y. 39	20
Neilson v. *Bishop*, 45 N. J. Eq. 473	17
Pollock v. *Farmers' Loan & Trust Co.*, 157 U. S. 429; 158 U. S. 601	36
Raymer v. *Trefry*, 239 Mass. 410	17
Roosevelt's Estate, In re, 143 N. Y. 120	30
Schenck v. *Barnes*, 156 N. Y. 316	19
Smietanka v. *First Trust & Savings Bank*, 257 U. S. 602	2, 14, 16
Stanfield's Estate, In re, 135 N. Y. 292	21

	Page
Stratton's Independence v. *Howbert*, 231 U. S. 399, 415	35
Towne v. *Eisner*, 245 U. S. 418	34
Townshend v. *Frommer*, 125 N. Y. 446	19
United States v. *Coulby*, 251 Fed. 982; affd. 258 Fed. 27	32
United States v. *Fidelity Trust Co.*, 222 U. S. 158	21, 22
Vanderbilt v. *Eidman*, 196 U. S. 480	25, 26
Van Kleeck, Matter of, 95 Misc. 40; affd. 177 App. Div. 917	19
Westhus v. *Union Trust Co.*, 164 Fed. 795	21, 22, 23, 25
Westurn's Estate, In re, 152 N. Y. 93	31
Williams v. *Thorn*, 70 N. Y. 270	19

FEDERAL STATUTES

Act of Sept. 8, 1916, c. 463, 39 Stat. 757	15
Act of Oct. 3, 1917, c. 63, 40 Stat. 331	16
Income Tax Act of Oct. 3, 1913, sec. 11, 38 Stat. 114, 166	3–5, 13, 14
Notes on Revenue Act of 1918, p. 11	32
Refunding Act of June 27, 1902, c. 1160, sec. 3, 32 Stat. 406	22
Revenue Act of 1921, sec. 215(b), 42 Stat. 242	31
War Revenue Act of June 13, 1898, c. 448, sec. 29, 30 Stat. 464	22

In the Supreme Court of the United States

OCTOBER TERM, 1924

ROSCOE IRWIN, FORMER COLLECTOR OF Internal Revenue, petitioner
v.
E. PALMER GAVIT
No. 325

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE PETITIONER

THE FACTS

Anthony N. Brady died prior to 1913, leaving a will which, among other things, established a trust of one-sixth of the residue of his estate for the purpose, primarily, of providing from the income thereof for the maintenance, education, and support, during her minority, of his granddaughter, Marcia Ann Gavit (daughter of E. Palmer Gavit). The trust further provided that any balance of the income of said estate remaining after the granddaughter had been adequately provided for should be divided into two equal parts, one to be paid to E. Palmer Gavit in equal quarter-yearly payments during his life, and the other to be accumulated for

the benefit of Marcia Ann Gavit. The trust was to terminate upon the death of the granddaughter, if she died before attaining her majority, in which event the entire capital of the trust estate was to go to her issue, if any, and if she left no issue to the issue of the testator. In any event, the trust was to terminate when the granddaughter reached the age of twenty-one years and the entire capital of the trust estate was then given to her. (R. 14.)

E. Palmer Gavit received substantial amounts of the income of this estate during the years 1913, 1914, and 1915, upon which the trustees failed to withhold the normal tax, and he, Gavit, failed and refused to pay either the normal or additional tax. As the result of such failure and refusal, taxes, additional taxes (or surtaxes), and penalties amounting in all to $21,602.16 were assessed and collected under the Income Tax Act of 1913. This action was instituted by Gavit to recover the amount paid with interest and costs. (R. 12.) The District Court gave judgment for the plaintiff in the sum of $30,104.70 (R. 19), and on writ of error (R. 27) the Circuit Court of Appeals for the Second Circuit affirmed the judgment (R. 35).

The Circuit Court of Appeals held that the moneys received by Gavit, while income as to the trust (although not taxable to the trust under the decision of this Court in *Smietanka* v. *First Trust & Savings Bank,* 257 U. S. 602) were as to Gavit legacies which, under Section II–B of the Income Tax Act of 1913, *infra,* were expressly excepted in

determining a person's net income for the purpose of taxation. (R. 34.)

Petitioner contends that the moneys paid to Gavit each quarter from the income of the trust were income derived by him from the trust and as such were specifically taxable under the provisions of Section II–B of the Income Tax Act of 1913, *infra*.

QUESTION PRESENTED

Where, under the terms of a trust created by will, periodical payments are made to a beneficiary out of the income of the corpus of the trust estate, are the amounts received taxable as income in the hands of such beneficiary even though he may not be entitled to receive any part of the corpus which yields the income?

STATUTE INVOLVED

The Income Tax Act of October 3, 1913 (38 Stat. 114, 166), provides in part as follows:

SECTION II

> A. Subdivision 1. That there shall be levied, assessed, collected and paid annually upon *the entire net income arising or accruing from all sources* in the preceding calendar year *to every citizen of the United States,* whether residing at home or abroad, and to every person residing in the United States, though not a citizen thereof, a tax of 1 per centum per annum upon such income, * * *.
>
> Subdivision 2. In addition to the income tax provided under this section (herein referred to as the normal income tax) there

shall be levied, assessed, and collected *upon the net income of every individual* an additional income tax (herein referred to as the additional tax) of 1 per centum per annum upon the amount by which the total net income exceeds $20,000 and does not exceed $50,000. [Here follow higher rates upon higher incomes.]

B. That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any lawful business carried on for gain or profit, or gains or profits *and income derived from any source whatever, including the income from but not the value of property acquired by gift, bequest, devise, or descent* * * *.

D. * * *; guardians, trustees, * * *, and all persons, * * * acting in any fiduciary capacity, shall make and render a return *of the net income of the person for whom they act, subject to this tax,* coming into their custody or control and management, and be subject to all the provisions of this section which apply to individuals * * *.

E. * * * All persons, * * * in whatever capacity acting, including * * * trustees acting in any trust capacity, * * * having the control, receipt, custody, disposal, or payment of interest, rent, salaries, wages, * * * or other fixed or determinable annual gains, profits, and income of another person, exceeding $3,000 for any taxable year, other than dividends on capital stock, or from the net earnings of corporations and joint-stock companies or associations subject to like tax, who are required to make and render a return in behalf of another, as provided herein, to the collector of his, her, or its district, are hereby authorized and required to deduct and withhold from such annual gains, profits, and income such sum as will be sufficient to pay the normal tax imposed thereon by this section, and shall pay to the officer of the United States Government authorized to receive the same; and they are each hereby made personally liable for such tax. * * *

ARGUMENT

I

What Gavit received was income, taxable at normal and surtax rates under Section II of the Income Tax Act of 1913

The direction of the donor to his trustees was to collect and receive the "*rents, income, and profits*" thereof and after paying all necessary expenses to

dispose of the "*net rents, income, and profits*" thereof as follows:

> I direct my executors and trustees to apply so much of said *net rents, income, and profits* * * *. The balance of said *net rents, income, and profits* shall be divided into two equal parts: One of the parts shall be paid to my son-in-law, Erastus Palmer Gavit, in equal quarter yearly payments during his life. The other moiety shall be accumulated for the benefit of my said granddaughter.

The donor then provided for the disposition of the "capital of said trust estate" upon the termination of the trust.

The courts below reached the fanciful conclusion that a man cannot receive the income from capital unless he owns the capital. If given the annual crops of a farm, the proceeds would not be his "income," unless he owned the farm in fee.

Such a conclusion, we submit, ignores the plain provision of the Act, the common sense of the very practical problem of taxation, and the common understanding of men. They graft an unwarranted limitation upon Paragraph B of Section II of the Act, which expressly taxes:

> *income derived from any source whatever, including the income from but not the value of property acquired by gift, bequest, devise, or descent* * * *.

Could words be plainer?

Nowhere in the statutes or adjudicated cases can there be found any authority for the proposition that gains to be income must be derived from the taxpayer's *own* labor or capital nor do the standard works on economics contain any such suggestion. On the contrary, Section II–B of the 1913 Act very clearly includes within the definition of taxable income " gains, profits, and income * * * growing out of the ownership or *use* of or *interest* in real or personal property." This provision specifically includes gains derived from the " use " as well as the ownership of property, and also from " interest in " property not necessarily involving ownership. One having a *legal right* to the accretions of a certain amount of capital has *income derived from capital,* and it is immaterial that the capital is not and never can become his own property.

It would surprise the man in the street, for whom taxing laws are made, to learn that if he were given, for a period of fifty years, the net profits of a great building or a great business that he was not in respect to the annual payments for that period of time in receipt of an annual income. Indeed, it is difficult to understand why an income tax should be levied upon the annual income from property which the taxpayer owns in fee, and should not be levied upon one who receives such income, even though he does not own the property in fee. The important fact is the income, not its source.

36709—25——2

If a testator were to leave a valuable piece of property to one of his sons, with the understanding that he should receive one-half of the income, but should pay the other half to his brother, on the theory of the lower court the first son would pay a tax, but the second son would be exempt. This seems to do violence to the purpose of the income tax laws.

They were the result of a political revolution. The American people had determined that they would no longer raise the vast sums necessary for the support of the Government wholly from consumption or excise taxes. They believed it to be more equitable that every man should pay according to his ability, and that ability was to be measured by the amount of his income.

In determining the nature of such income, the law purposely excluded such an isolated and nonrecurring gift as a legacy. It was not income in the proper sense of the word. It was an accidental receipt, which might never happen again; and while it might be spent by the happy beneficiary as though it were income, it was more likely to become a part of his principal. When, however, a trust is created, which continuously yields income, and that income and not the corpus is given to a beneficiary, the latter naturally regards the ever-recurring receipts of money as a part of his income; and it was certainly the income which Congress had in mind in determining his relative ability to contribute to the Government, for not only did

the Sixteenth Amendment tax income "from whatever source derived," but the law provided a tax upon "income derived from any sources whatever, including *the income from* but not the value of property acquired by gift, bequest, devise, or descent."

It seems to us difficult for Congress to have expressed its meaning more comprehensively or clearly. The value of the property "which is given in trust" by a gift or devise is not taxable, as it happens in the nature of the case only once, but the income from that property is taxable in the hands of the beneficiary without regard to the technical ownership of the trust fund. Any other conclusion would lead to extraordinary results. If charities were not exempt, then, if a bequest of $100,000,000 were made to a charity in perpetuity, the income of that trust fund would never for all time be income within the meaning of the statute, and this would seem to be a *reductio ad absurdum*.

Such a definition is clearly at variance with the plain intendment of the Act, and if permitted to stand would result in the exemption of all income received by beneficiaries of trust estates, who do not share in the distribution of the capital assets. This would deprive the Government of an exceedingly large amount of revenue and result in large sums of money and holdings of property being transferred in trust, in order to secure for the beneficiaries thereof tax-free income.

The decision of this Court in the case of *Maguire* v. *Trefry,* 253 U. S. 12, directly refutes the contention that earnings of capital, in order to be income to the recipient thereof within the meaning of the Income Tax Act of 1913 and the Sixteenth Amendment to the Constitution of the United States, must be a gain derived from a capital or corpus actually owned by the recipient of the income.

In *Maguire* v. *Trefry,* this Court held that a Massachusetts statute providing for a tax upon incomes (Gen. Statutes, Massachusetts, 1916, c. 269, Secs. 9, 11) applied to the income of a resident of the state from a trust administered under the laws of another state in securities in the possession of the trustee in such other state, because the beneficiary had an equitable right, title, and interest distinct from the legal ownership.

Speaking for this Court in *Maguire* v. *Trefry, supra,* Mr. Justice Day quoted with approval the following language of the Chief Justice of the Supreme Judicial Court of Massachusetts:

> " The income tax is measured by reference to the riches of the person taxed actually made available to him for valuable use during a given period. It establishes a basis of taxation directly proportioned to ability to bear the burden. * * * It is true of the present tax, as was said by Chief Justice Shaw in *Bates* v. *Boston,* 5 Cush. [Mass.] 93, at page 99, ' The assessment does not touch the fund, or control it; nor does it interfere with the trustee in the exercise of his proper

> duties; nor call him, nor hold him, to any accountability. It affects only the income, after it has been paid by the trustee ' to the beneficiary."
>
> We see no reason to doubt the correctness of this view of the nature and effect of the Massachusetts statute, and shall accept it for the purpose of considering the federal question before us * * *. [253 U. S. 12, 14.]

Mr. Justice Day said further, and his language is distinctly applicable to the facts in the case at bar:

> It is true that the legal title of the property is held by the trustee in Pennsylvania. But it is so held for the benefit of the beneficiary of the trust, and such beneficiary has an equitable right, title and interest distinct from its legal ownership. " The legal owner holds the direct and absolute dominion over the property in the view of the law; but the income, profits, or benefits thereof in his hands, belong wholly, or in part, to others." 2 Story's Equity, 11th Ed., Sec. 964. It is this property right belonging to the beneficiary, realized in the shape of income, which is the subject-matter of the tax under the statute of Massachusetts. [253 U. S. 12, 16.]

In *Merchants' Loan & Trust Co.* v. *Smietanka,* 255 U. S. 509, the income of a testamentary trust was held taxable under the Revenue Act of 1916,

and this Court, after referring to its previous definitions of income, said that (p. 519):

> There can be no doubt that the word [income] must be given the same meaning and content in the Income Tax Acts of 1916 and 1917 that it had in the Act of 1913.

The lower courts, in the case at bar, recognized that the "rents, income, and profits" of the trust estate created by the will of Brady, were income to the trust (*Merchants' Loan & Trust Co.* v. *Smietanka, supra*), but held that they were not income to the beneficiary, Gavit. Their metamorphosis from income to capital or from taxable income to nontaxable income during their passage from trustee to beneficiary is not explained. Can such verbal legerdemain be imputed to a practical Congress in imposing a practical law? But if the word "income" has the same meaning under the 1916 Act as it has under the 1913 Act, *Merchants' Loan & Trust Co.* v. *Smietanka, supra*, is authority for the proposition that bequests of income of a testamentary trust are taxable. The widow of Ryerson, in the *Merchants' Loan & Trust Co. case* had only a life interest, and no capital interest in the trust fund, which upon the death of the life tenant was to go to the children of the testator. So far as the accumulations of income by the trust were concerned, it was not regarded of any importance whether the beneficiaries owned any part of the corpus or not.

The 1913 Act as well as the later Acts taxes the *income*, but not the value, of property acquired by gift, bequest, devise, or descent. What was taxed in the hands of Gavit was not the value of his inheritance, but the income derived therefrom. Gavit never received his income from Brady, because it was not in existence when Brady died. It had to be earned before it could be paid to him, and if the corpus of the trust had earned nothing, Gavit would have received nothing.

The Income Tax Act of 1913, Par. A, Subd. 1, levies a normal tax of one per cent upon the entire yearly net income arising from all sources accruing to every citizen of the United States and to every person residing in the United States, though not a citizen thereof. In Subd. 2 of Par. A, an additional or surtax is levied on the net income of every individual. Under Par. G, the normal tax imposed on individuals is extended to corporations. Paragraph B defines "net income" of individuals and specifies the exemptions and deductions. Paragraph D makes provision for returns by persons and then says:

> Guardians, trustees, executors, administrators, agents, receivers, conservators, and all persons, corporations, or associations acting in any fiduciary capacity, shall make and render a return of the net income of the person for whom they act, subject to this tax, coming into their custody or control and management, and be subject to all the pro-

> visions of this section which apply to individuals * * *.

Paragraph E provides that, among others, all lessees or mortgagors of real or personal property, trustees acting in any trust capacity, executors, administrators, agents, receivers, or conservators, having control, receipt, custody, disposal or payment of annual gains, profits and income of another person, exceeding $3,000 for any taxable year, who are required to make return in behalf of another, shall deduct the normal tax on the income and pay it to the United States, and they are each made personally liable for such tax. It is further declared that these payments of the tax at the source shall only apply to the normal tax thereinbefore imposed on individuals.

There is no disputing the fact that Gavit was a person subject to the tax under the foregoing provisions; that what he received answers to the description of net income in every respect; and it is submitted that the tax should have been paid by the trustees *withholding the normal tax* and Gavit paying the *surtax*. Such is the effect of the decision of this Court in *Smietanka* v. *First Trust & Savings Bank*, 257 U. S. 602, 605, in which the Court said:

> It is obvious from a reading of the statute, the relevant provisions of which we have summarized, that Congress was seeking to require fiduciaries to make return and pay the normal tax due from persons subject to the tax on such income as the fiduciaries

were receiving for such persons. There was nowhere in the act a payment required of the fiduciary of a tax upon the income of the estate or trust property, the income from which he collects, except as it is to enure to the benefit of a person or an individual from whose income he is authorized and required to deduct the normal tax thereon. There must have been a taxable person for whom the fiduciary was acting to make the provisions relied upon by the Government applicable. There was no provision for the payment " at the source " by the fiduciary of anything but the normal tax. It was intended that the additional or surtax should be paid by the *cestui que trust*. Here there was no *cestui que trust* to pay a surtax.

This Court held that the Income Tax Act of 1913 made no provision for taxing income held and accumulated by a trustee *for unborn and unascertained beneficiaries*. The same statute was involved there as here. The same years were involved, i. e., 1913, 1914, and 1915. The said case likewise involved a testamentary trust. But the question was whether the income of the trust, *accumulated for the benefit of unborn and unascertained persons*, was taxable to the trustee. Here the question is *whether income distributed periodically to a living and ascertained beneficiary is taxable to him*.

The Act of September 8, 1916, c. 463, 39 Stat. 757, specifically declared that the income accumulated

in trust for the benefit of unborn or unascertained persons should be taxed and assessed to the trustee, and under said Act as amended (Act of October 3, 1917, c. 63, 40 Stat. 331) trustees were required to render a return of the income of the person, *trust, or estate* for whom or which they act. *Merchants' Loan & Trust Co.* v. *Smietanka,* 255 U. S. 509. There is nothing in either opinion of this Court (*Smietanka* v. *First Trust & Savings Bank, supra,* and *Merchants' Loan & Trust Co.* v. *Smietanka, supra*) even faintly suggesting that the income of testamentary trusts is or was totally exempt or excepted from taxation as a gift or legacy.

The error of the Circuit Court of Appeals lies in confusing the income from a legacy with the legacy itself. Under the Act the former is taxed as income while the latter is not. What Gavit in fact took under Brady's will was a vested beneficial interest in the trust estate, enforceable in a court of equity, and which consisted of the right to receive, under certain conditions, a portion of the income of said trust estate. On this *interest or use* there was no tax because he received it as a bequest. On the other hand, what income Gavit received from the trustees of the estate was taxable. It falls squarely within the provisions of Section II–B of the Income Tax Act of 1913, defining net income as including " gains, profits, and income * * * growing out of the ownership *or use of or interest in* real or personal property * * *

including the income from * * * property acquired by gift, bequest, devise, or descent." The reasoning of this Court in the case of *Maguire* v. *Trefry,* 253 U. S. 12, distinguishing between ownership and equitable interest in the same property, should be controlling in the case at bar on this point.

Gavit's interest in the trust fund was "property," the "value" of which is exempt from tax as income because received as a bequest. As stated by Rugg, C. J., in the case of *Raymer* v. *Trefry,* 239 Mass. 410, 413, "'Property' is a word of large import. It has been interpreted as including the right to make contracts for labor and for personal service." Nor is it material that Gavit's participation in the income of the trust was contingent; his interest vested upon the death of the testator. The general policy of the law and the rules of interpretation require that legacies in all cases, unless clearly inconsistent with the intention of the testator, should be held to be vested, rather than contingent. The fact that the enjoyment is uncertain never interferes with the vesting of an estate. When the contingency is not in the person, but in the event when enjoyment shall commence, or in the time of the enjoyment, the interest is considered vested. *Neilson* v. *Bishop,* 45 N. J. Eq. 473.

"Income" from capital must be, not capital, but the proceeds of capital. A gift or bequest of capital assets even if payable in installments is not "income." Here not a portion of the capital assets

forming the corpus, but certain of the earnings thereof, passed to the *cestui que trust*. The *cestui que trust* has an interest in the corpus, because he is legally entitled to receive whatever income is given him and must have the right to enforce payment if it is wrongfully withheld. If he has no such right, then each payment becomes a mere gratuity because each is an act of grace. To illustrate, I may give to my daughter from time to time and as and when it accrues the interest on certain bonds which belong to me. This interest so given is not "income" in the hands of my daughter, because I may withhold it at will, and, hence, each payment of interest is a gift. But if I create an irrevocable trust and turn over those bonds to a trustee with the provision that she shall have the interest therefrom through a term of years, or for life, then such interest is "income," because she has a legal right thereto and may enforce payment thereof in accordance with the terms of the trust. It is this *right* to the income which gives the *cestui que trust* a legal interest in the corpus. It is the right *in* the corpus, though not *to* the corpus, which we assert makes the usufruct "income" within the statute.

Nor is this conclusion one which is arrived at by a process of abstract reasoning. As has been seen, the act of 1913 specifically taxes income "growing out of the ownership or use of *or interest in* real or personal property." Therefore, it must inevitably

follow that if Gavit had an "interest in" the corpus, the proceeds thereof coming into his hands were taxable income.

In denying that the *cestui que trust* had any interest in the principal the lower courts ignored the law of the State of New York as to trust estates. The District Court thought that Gavit had no substantial or tangible right because the trustees, in their discretion, might have devoted all the proceeds of the corpus to the support of Marcia Ann Gavit, leaving nothing for him to take. The answer is obvious. The trustees did exercise their discretion each year and, after so doing, there did remain a surplus of earnings, one-half of which then belonged to Gavit. The trustees had no option but to turn it over to him. It was his. Had they failed so to do, he could have sued to compel due performance of the trust. The substantiality of that interest can not be argued away because of any fancied analogy with vested and contingent remainders in property. It is provided by *Section 100 of the Real Property Law of New York* that the trustee takes the whole estate and that the *cestui que trust* shall have a right of action to compel the enforcement of the trust. This same rule applies to trusts of personal property. *Williams* v. *Thorn,* 70 N. Y. 270; *Townshend* v. *Frommer,* 125 N. Y. 446; *Matter of Van Kleeck,* 95 Misc. 40, affd. 177 App. Div. 917. The right so to enforce is declared to be a chose in action. *Schenck* v. *Barnes,* 156 N. Y. 316. In *Met-*

calfe v. *Union Trust Company,* 181 N. Y. 39, it was argued that the right of a *cestui que trust* to take proceeds from corpus during life or until remarriage was not an estate or substantial interest. The Court of Appeals of the State of New York rejected this doctrine and said (p. 44):

> Although the legal estate is in the trustee, he but possesses a naked right, which is to be exercised, not for his own benefit, but for that of another. His estate is commensurate with the trust duties imposed upon him and it ceases when they are performed, or when they are at an end. The whole beneficial proprietorship, or interest, is in the *cestui que trust,* for whom he holds the estate and who has the right to enforce the performance of the trust.

The statutes and the decisions thereunder make no distinction between the interest of a *cestui que trust* which is absolute or which is contingent upon some condition. In either case he has a beneficial proprietorship in the corpus and whenever there are proceeds from that corpus, to which, under the trust, he becomes entitled, he has a right given by the statute to compel the payment to him. Even if no usufruct had ever actually become due to Gavit he would have had the right to sue the trustees if they were wasting the corpus. Therefore it is plain that the *cestui que trust,* E. Palmer Gavit, does have a substantial interest in the corpus of the estate, so that even under the limitations laid down

in the opinion of the court below he was in receipt of " income."

II

The cases cited by the Circuit Court of Appeals are inapplicable

Too much weight has been given to the decision of the Court of Appeals of New York in the case of *In Re Stanfield's Estate,* 135 N. Y. 292 (decided October 4, 1892), *United States* v. *Fidelity Trust Co.,* 222 U. S. 158 (decided December 4, 1911), *Westhus* v. *Union Trust Co.,* 164 Fed. 795 (decided November 4, 1908), and *Lynch* v. *Union Trust Co.,* 164 Fed. 161 (decided October 5, 1908). None of these cases had anything to do with tax on income, or the exemption from taxation as income of money or property received by gift, bequest, devise, or descent.

In the matter of *Stanfield's Estate, supra,* Hugh M. Stanfield, as beneficiary under the will of Mark M. Stanfield, deceased, was given the income of $20,000 for life, and the executor was directed by the will to invest $20,000 for such use in bonds and mortgages or Government bonds. He petitioned for an order directing the payment of interest on the amount of income devised to him. The Supreme Court granted the order (18 N. Y. Supp. 913), which was affirmed by the Court of Appeals, the affirmance being accompanied by the opinion which has been so strongly relied upon by E. Palmer Gavit in support of the proposition that the income

paid to him from the Brady estate was exempt from taxation.

We submit that such reliance is not well grounded. The question in *Stanfield's case* was not whether what the distributee received was income or a legacy for the purposes of his income tax, but whether he was entitled to receive said income from the date of the death of the testator. It was held that the beneficiary was entitled to the income on said $20,000 from the date of the testator's death and that it was not subject to the rule that general legacies shall not bear interest until the expiration of one year from the grant of letters testamentary or of administration. The court held that the rule by its terms was limited to general legacies payable out of the corpus of the decedent's estate.

The cases of *Westhus* v. *Union Trust Co.*, 164 Fed. 795, *Lynch* v. *Union Trust Co.*, 164 Fed. 161, and *United States* v. *Fidelity Trust Co.*, 222 U. S. 158, cited by the learned Circuit Court of Appeals in support of the proposition that each annual payment to Gavit from the income of the trust estate constituted a legacy, arose under the War Revenue Act of June 13, 1898, c. 448, Sec. 29, 30 Stat. 464, and the so-called " Refunding Act " of June 27, 1902, c. 1160, Sec. 3, 32 Stat. 406. The " Refunding Act" provided for the refunding of such taxes "as may have been collected on contingent beneficial interests which shall not have become vested prior to July first, nineteen hundred and two," and that no tax should be assessed under said Section 29 in

respect of any contingent beneficial interest which shall not become absolutely vested in possession or enjoyment prior to July 1, 1902. These cases afford little support to the position of respondent.

In *Westhus* v. *Union Trust Company, supra,* the testator died December 11, 1901, leaving a will whereby after payment of his debts and certain specific legacies he bequeathed all his property to a trust company in trust, with direction that the net income of the trust estate, after a deduction not material here, should be divided into three equal parts called A, B, and C, respectively. This case has to do only with part C. The will provided that the trust company should pay the net income represented by part C to the testator's son, Charles A. Madill, at least semiannually during his life time, with remainders after his death to other persons upon various contingencies. The will denied the testator's son, who was the beneficiary of part C of said trust, all right or power to anticipate his portion of the income or to sell, pledge, hypothecate, or otherwise encumber the same before the trust company had actually paid it to him. There was like denial of control over the principal or corpus of the trust property, and neither income nor corpus was to be subject to the payment of his debts. In short, testator's son had no *ownership* whatever in the *corpus* of the estate. His bequest was simply the right to receive income therefrom.

The Circuit Court of Appeals for the Eighth Circuit held that under the above-mentioned stat-

utes testator's son received a life estate in the income of the trust property, which became absolutely vested in enjoyment at once on the death of the testator and subject to the tax. This is clearly a holding that the testator's son received a "bequest," although, like Gavit in the case at bar, he received from the testator no part of the *corpus* of the trust fund, or *ownership* therein, but only a right to receive the income thereof. The court said:

> We think the bequest to Charles A. Madill was absolutely vested in enjoyment at the death of the testator. The right of the legatee to the enjoyment of the income was not postponed to the end of a precedent estate, nor was it made to depend upon the happening of any contingency or uncertain event. A present and immediate right passed to him, not subject to devestment short of his death. The interest which passed by the will and in respect of which the tax was imposed was an ordinary life estate in the income of property held in trust, and the beneficiary was a person in being. The intervention of a trustee between the legatee and the physical handling of the corpus of the estate is unimportant in this connection. True, the precise amount of the income depended upon the amount or value of the corpus of the trust property, the definite ascertainment of which might have to await the payment of debts and the preparation of schedules, but such an uncertainty no more makes a bequest of income contingent than does the

> fluctuation of rates of interest upon the invested funds of the trust estate. [*Westhus* v. *Union Trust Company*, 164 Fed. 795, 797, 798.]

In *Vanderbilt* v. *Eidman*, 196 U. S. 480, the income of a residuary estate was to be paid to a son of the testator while he was between 21 and 30 years of age. He was then to receive one-half of the principal and the income on the balance until he was 35 and then the balance was to be given into his possession. *The tax was duly paid upon the right to the beneficiary's enjoyment of the income*, as provided by the Act of 1898, and the controversy arose over the subsequent exaction by the Government of a tax on his right to succeed to the whole residue if he lived to the ages of 30 and 35 years, respectively. The Court held that the deferred rights were not vested in possession or enjoyment and were therefore not subject to the tax. The case is only pertinent here in respect of the general acquiescence in the liability to the tax of *the bequest of the income* in trust for the son. To that extent it supports our proposition that the bequest of a right to receive income is a legacy and the annual accretions to the legatee growing out of such right or interest in property is income.

In the case of *Disston* v. *M'Clain*, 147 Fed. 114, the testator gave the residue of his estate to trustees—

> to keep the same invested in such securities as I may have or to invest the same as

> they may determine, and from the income arising from all my said estate to pay first to my beloved friend, Rachael Asch, the sum of fifteen thousand dollars per year during all the term of her natural life.

The Circuit Court of Appeals for the Third Circuit held that the estate of a testator was not subject to the payment of a legacy tax under said War Revenue Act of June 13, 1898, as a legacy of an entirety for life merely because a fixed income for life was to be paid to a beneficiary out of the whole income of the real and personal estate in the hands of trustees, but in such case the specific payments only were taxable as the same from time to time became due and payable to the legatee. The court very properly distinguished such a case from one where a beneficiary is given an equitable interest in a certain fixed part of the corpus of the estate, as in the *Westhus case* and as in the case at bar. The court said:

> * * * it must be observed again, that the express bequest of all the income, be it more or less, from the entire residuary personal estate, during a definite period, differs widely, as regards the question here presented, from the bequest of a definite sum to be paid yearly out of the income of both real and personal estate, collected by the trustees. [*Disston* v. *M'Clain*, 147 Fed. 114, 120, 121.]

The reason why the court, in *Disston* v. *M'Clain*, held that each separate payment to the beneficiary

was a separate bequest was because there was no sum given to the trustees or set apart by the will, the income of which was to be paid to Rachael Asch. *There was nothing definite or capable of being made definite as to the source from which the income was to be derived.* The court made this clear throughout its opinion, particularly on pages 117 and 118, in the following language:

> To sustain the action of the collector, we have to ignore the fact that there is no gift to Rachael Asch of a definite sum, as an entirety, other than the quarterly payments which the trustees of his residuary estate, real and personal, are directed to make out of the income thereof, year by year, during the term of her life. Nor is any sum given to the trustees or set apart by the will, the income of which, whatever it may be, is to be for the use of Rachael Asch. To create the corpus of a legacy, the income of which will supply these definite quarterly payments, would impose upon the trustees the necessity of setting apart such an amount of money as would, in their judgment, produce the income, thus creating a principal sum or corpus which the testator has not seen fit to create in the shape of a legacy * * *.
>
> There is nothing definite or capable of being made definite as to the source from which the income is derived. Presumably the income collected by the trustees was more than sufficient to make these definite payments. Neither the personal estate nor real estate is bequeathed and devised as an

> entirety for the raising of these sums. The character of the bequest is not to be determined by the adventitious relation of the amount of the personalty to that of the realty, or by the requirement of the Pennsylvania law as to the primary application of the personalty, or by the more or less amount of income derived from the personalty. It might have happened that the testator's personal estate had been so invested as to yield an income more than sufficient to make the payments in question. The mere fact that it was found so invested as that the income was not adequate for that purpose, can not impose a different legal character upon this provision of the testator's will, or authorize the collector to consider the whole personal estate as a legacy and taxable as an entirety, and for that purpose to ascertain its value as a life interest. Such a construction of the revenue act of 1898 is, we think, unwarranted by its plain language and unsupported by any authoritative interpretation of it.

The case of *Lynch* v. *Union Trust Company, supra,* is analogous to that of *Disston* v. *M'Clain;* indeed, it was said by the court to be "exactly on all fours" with it. It will not, therefore, be commented upon in detail here.

It is also to be noted that the court in *Disston* v. *M'Clain* distinguished *Vanderbilt* v. *Eidman, supra,* on the grounds that the same question was not involved, and even if it was—

> the express bequest of all the income, be it more or less, from the entire residuary personal estate, during a definite period, differs widely, as regards the question here presented, from the bequest of a definite sum to be paid yearly out of the income of both real and personal estate, collected by the trustees. [*Disston* v. *M'Clain,* 147 Fed. 114, 120, 121. See also *Herold* v. *Shanley,* 146 Fed. 20.]

It is respectfully insisted that the foregoing decisions under the War Revenue Act of June 13, 1898, are not in point. There the question was as to the construction of an inheritance tax law—here it is the construction of an income tax law, involving radically different considerations. In those cases the question was not "what is the legacy, and what the income therefrom," but whether the so-called legacy met the definition of the Act there involved. As stated by the court in *Disston* v. *M'Clain, supra,* at page 122:

> The statute nowhere refers in express terms to the interest or income of a legacy, nor does it impose any tax in respect thereto, before it is actually received. If the act had intended that the interest in a fixed and definite income for life, payable out of personalty alone, much more in such an income payable *out* of the total income of the whole residuary real and personal estate, should be taxed, this intention would not be left to inference, but would be clearly expressed and a mode of estimating such an interest would be prescribed, as, for example, has been done

> in the collateral inheritance tax laws of the States of New York and New Jersey. In this statute, there is no mode provided for valuing such an income given to a person for life.

So the decisions under said Act are to be considered in connection with the definitions and limitations of the Act itself, and are not aptly applied to a question of income tax arising under the Act of 1913, which taxes "the income from but not the value of property acquired by gift, bequest, devise, or descent."

Although not apparent from the record, it seems to be a fact that Gavit's interest in the Brady estate was taxed by the State of New York as an inheritance at a present value of $2,731,972.00. But even if it had been impossible to have determined the value of Gavit's right or interest at the time of Brady's death, that difficulty should give us little concern here. We know that it was a valuable right or interest and resulted in large amounts of annual income, which income is the subject of this suit. It is the rule under the New York Inheritance Tax law that in cases where there is a technical vesting of a future estate, which is liable to be defeated before it comes into actual enjoyment, as well as where there is no such contingency, the tax is upon the interest of each legatee, according to its value, and collectible out of his interest only. (*In re Hoffman's Estate,* 143 N. Y. 327; *In re Curtis,* 142 N. Y. 219; *In re Roosevelt's Estate,* 143 N. Y. 120; *In re Westurn's*

Estate, 152 N. Y. 93; see also *In re Cager's Will,* 111 N. Y. 343.)

III

The effect upon the Income Tax Acts of 1916, 1918, 1921, and 1924

The most important aspect of the decision of the Circuit Court of Appeals is not the obvious error in this particular case, but the serious and far-reaching effect upon the whole income-tax system of the Government. Under the Revenue Acts of 1916, 1918, and 1921, testamentary trusts are taxable persons and beneficiaries thereof are taxable on their distributive shares. The effect of the decision of the Circuit Court of Appeals is to exempt from taxation the income received by beneficiaries of testamentary trusts where the beneficiary does not own the corpus of the trust estate. Most trusts are testamentary, and many of them create life estates in persons who are not remaindermen. Consequently the decision, if unreversed, may be held equally applicable to the later Acts so far as distributive shares of income are concerned. Already, in fact, the decision is being urged as determinative of the identical question in many cases now pending before the Treasury Department and the courts under the later Acts.

Section 215 (b) of the Revenue Act of 1921, specifically provides that (42 Stat. 242):

> Amounts paid under the laws of any State, Territory, District of Columbia, possession

> of the United States, or foreign country as income to the holder of a life or terminable interest acquired by gift, bequest, or inheritance shall not be reduced or diminished by any deduction for shrinkage (by whatever name called) in the value of such interest due to the lapse of time, nor by any deduction allowed by this Act for the purpose of computing the net income of an estate or trust but not allowed under the laws of such State, Territory, District of Columbia, possession of the United States, or foreign country for the purpose of computing the income to which such holder is entitled.

This provision is a legislative recognition of the scope and intent of prior laws rather than a change in such laws. *United States* v. *Coulby,* 251 Fed. 982, affirmed 258 Fed. 27.

In this connection attention is respectfully invited to a letter dated November 3, 1919, from the Secretary of the Treasury to the Chairman of the Committee on Ways and Means of the House of Representatives, relative to the provision which was finally enacted as Section 215 (b) of the 1921 Act. (Notes on the Revenue Act of 1918, p. 11.) In that letter the Secretary stated that the proposed change was desired in order to clear from doubt the status of life interests or estates. He said:

> Certain State statutes and the decisions thereunder give color to the claim that the value of a life interest at the time received is such a capital value as may serve as the

> basis of deductions for obsolescence. If these claims be allowed, cases would arise in which a clear income from an unimpaired corpus, divided between a life tenant and remainderman, would entirely escape taxation—the income from the property being wiped out by the annual shrinkage or obsolescence of the so-called capital value of the life estate.

The foregoing amendment has to do principally with depreciation of life estates, but it shows a legislative intention to tax as income the proceeds of property held in trust, regardless of the ownership of the corpus.

Furthermore, in this connection, it is to be noted that all the Revenue Acts since 1913, not only tax the distributive shares of income of trusts to the beneficiaries, but also exempt from taxation "the value of property acquired by gift, bequest, devise, or descent." Hence, if, as held in this decision, a beneficiary's distributive share of the income of a trust estate, where he owns no part of the corpus, is not income, but a legacy, then the provision of said Acts taxing such distributive shares and the provisions exempting legacies from taxation are in hopeless conflict.

IV

Constitutional question involved

The Circuit Court of Appeals, while not expressly holding any specific part of the Income Tax Act of 1913 unconstitutional, in ruling that

what Gavit received under the Act was not income, but a legacy, cited *Towne* v. *Eisner,* 245 U. S. 418, to the effect that " What in its nature is not income can not be made such merely by Congress calling it such." This reference could only have been with respect to the fact that the Act taxes income from legacies regardless of the ownership of the corpus, and suggests the unconstitutionality of the Act. In brief, the suggestion is that a bequest of income can not be " income " under the Sixteenth Amendment, where the beneficiary owns no part of the corpus, and is not made income by Congress calling it such. Under this theory Congress has no power to tax the income from property acquired by gift or legacy where income is bequeathed apart from the corpus, but under such circumstances both the value of the property itself and the income therefrom are necessarily exempt. To this theory we can not subscribe.

The income from a legacy is taxable as income whether the legatee owns any part of the corpus or not. *Baltzell* v. *Casey,* 1 Fed. (2d) 29; affd. by the Circuit Court of Appeals, 1st Cir., Jan. 14, 1925, unreported to date.

There is no force in the argument that each annual payment to Gavit was a payment of capital. The value of his capital was not diminished one cent by all the payments to him. In fact, it appreciated during the years here involved, resulting in increased income to Gavit therefrom. That his expectancy of years of enjoyment diminished with

the lapse of time is immaterial; the value of the right or interest in the estate did not diminish.

As stated by Mr. Justice Pitney in *Stratton's Independence* v. *Howbert,* 231 U. S. 399, 415, with reference to such an argument:

> But the same is true of the earnings of the human brain and hand when unaided by capital, yet such earnings are commonly dealt with in legislation as income.

And in the case of *Merchants' Loan & Trust Co.* v. *Smietanka,* 255 U. S. 509, 519, Mr. Justice Clarke said:

> In determining the definition of the word "income" thus arrived at, this court has consistently refused to enter into the refinements of lexicographers or economists and has approved, in the definitions quoted, what it believed to be the commonly understood meaning of the term which must have been in the minds of the people when they adopted the Sixteenth Amendment to the Constitution. *Doyle* v. *Mitchell Bros. Co.,* 247 U. S. 179, 185; *Eisner* v. *Macomber,* 252 U. S. 189, 206, 207.

There is, and always has been, ample power in Congress to tax income from whatever source derived. The Sixteenth Amendment added nothing to the existent power of Congress to tax. Indeed, the power was complete and required no enlargement. The amendment changed only a regulation of the Constitution as to the mode of exercising the power under particular circumstances. As pointed

out in *Brushaber* v. *Union Pacific R. Co.*, 240 U. S. 1, 16, the conclusion reached by this Court in the case of *Pollock* v. *Farmers' Loan & Trust Company*, 157 U. S. 429; 158 U. S. 601,

> did not in any degree involve holding that income taxes generically and necessarily came within the class of direct taxes on property, but on the contrary recognized the fact that taxation on income was in its nature an excise entitled to be enforced as such unless and until it was concluded that to enforce it would amount to accomplishing the result which the requirement as to apportionment of direct taxation was adopted to prevent, in which case the duty would arise to disregard form and consider substance alone and hence subject the tax to the regulation as to apportionment which otherwise as an excise would not apply to it.

In the *Brushaber Case* the Court further said (p. 17):

> Nothing could serve to make this clearer than to recall that in the *Pollock Case* in so far as the law taxed incomes from other classes of property than real estate and invested personal property, that is, income from " professions, trades, employments, or vocations " (158 U. S. 637), its validity was recognized; indeed it was expressly declared that no dispute was made upon that subject and attention was called to the fact that taxes on such income had been sustained as excise taxes in the past. *Id.*, p. 635. The whole law was however declared unconsti-

tutional on the ground that to permit it to thus operate would relieve real estate and invested personal property from taxation and " would leave the burden of the tax to be borne by professions, trades, employments, or vocations; and in that way what was intended as a tax on capital would remain, in substance, a tax on occupations and labor," (*Id.*, p. 637) a result which it was held could not have been contemplated by Congress.

This is the text of the Amendment:

" The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

The purpose of the amendment was stated clearly and succinctly by this Court in the *Brushaber case* (p. 18), as follows:

* * * the whole purpose of the Amendment was to relieve all income taxes when imposed from apportionment ~~from~~ a consideration of the source whence the income was derived. * * * there is no escape from the conclusion that the Amendment was drawn for the purpose of doing away for the future with the principle upon which the *Pollock Case* was decided; that is, of determining whether a tax on income was direct not by a consideration of the burden placed on the taxed income upon which it directly operated, but by taking into view the burden which resulted on the property from which

> the income was derived, since in express terms the Amendment provides that income taxes, from whatever source the income may be derived, shall not be subject to the regulation of apportionment.

There is no force, therefore, in the argument that the income derived by Gavit from the Brady trust could not be taxed under the Constitution, unless it is on the ground that what he received was *not income*. If it be conceded that what he received was *income*, the constitutionality of the tax must be apparent: for, admittedly, the Congress has power to tax *all income, from whatever source derived.*

In the enactment of the 1913 Act there is every indication that Congress used the word "income" in its popular and broadest sense, "It being very clear that Congress intended in that act to exert its power to the extent permitted by the Amendment." (*Eisner* v. *Macomber,* 252 U. S. 189, 203.) And in *Lynch* v. *Hornby,* 247 U. S. 339, 343, 344, this Court said:

> * * * Congress was at liberty under the Amendment to tax as income, without apportionment, everything that became income, in the ordinary sense of the word, after the adoption of the Amendment * * *.

Congress has exercised its power by taxing the "*income from* * * * property acquired by gift, bequest, devise, or descent," but exempting the value of the property itself. The exemption was not by reason of lack of power to tax, and even

though it be made to appear that the income is the legacy, if it answers to the description of income, the Congress has complete power to tax it as income.

As heretofore stated, any exemption or deduction claimed by respondent must be by virtue of the taxing statute, and not by virtue of any constitutional limitation.

JAMES M. BECK,
Solicitor General.

CHESTER A. GWINN,
Special Attorney,
Bureau of Internal Revenue,
Of Counsel.

APRIL, 1925.

○